MULTIMEDIA UNIVERSITY

STUDENT ID NO

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# MULTIMEDIA UNIVERSITY

# FINAL EXAMINATION

**TRIMESTER 3, 2021/2022**

## BAC4674 – INTEGRATED CASE STUDY IN ACCOUNTING

(All Sections/Groups)

12 AUGUST 2022
9.00am – 12.00pm
(3 Hours)

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## INSTRUCTIONS TO STUDENT

1. This question paper consists of **SIX** pages (including cover page) with **FOUR** questions only.
2. Answer **ALL** questions. Distribution of the marks for each question is given.
3. Write your answers and workings in the Answer Booklet provided.

# Tragedy of Transition Airlines

Transition Airlines was the first airline company founded by the Grane government in 1942 when the airline industry was still at its infancy in Grane. The initial objective of Transition Airlines was to provide convenience for Grane's citizens to travel domestically and internationally. There was an economic boom in Grane in the 1980s and Transition Airlines achieved significant growth during this period. In the early 1980s, Transition Airlines was privatized, and its shares were listed on Grane's stock exchange. The initial public offering (IPO) of Transition Airlines was overwhelming. Soon, Transition Airlines started to expand, and it took all the domestic routes within Grane and many international routes. Transition Airlines was flying to over 50 overseas destinations. It was well-recognized in both its home country and overseas. Customers praised the airline for its great service and affordable price. It could be said that it was one of the best airlines at that time.

The airline company diversified its operations into a few related industries and sectors. Transition Airlines had expanded its business to Transition Cargo and Transition Holiday. These operations acted as supplements to the commercial airline business and helped to boost its revenue. Transition Cargo provided air freight services by delivering parcels using Transition Airlines while Transition Holiday provided holiday packages and handled ground tours for its customers, while all the passengers were flying using Transition Airlines. These operations had increased the airline's revenue while reducing its expenses as it did not need to incur extra expenses by having suppliers to provide the in- flight meals and other advertising expenses for the local tours to promote the airline.

Transition Airlines was privatized in 1980's due to suffering losses. It was due to the high interest rates and escalating fuel prices. The government had the power to control fares in line with the policy of promoting trade and tourism in Grane. Many nationalized industries were suffering losses. Selling them was one of the ways to reduce the budget deficit. The government had its own financial priorities and considerations, thus limiting the funds available to Transition Airlines for expansion. The growth of the company had been limited too. The leader of the country believed that both the government and companies would benefit from the privatization of Transition Airlines and other national companies. Budget deficit problems may be improved, and it would be an incentive for Transition Airlines to perform better in the future.

The government had decided to list the company on the stock exchange. The airline company offered 40% of its capital for sale to Grane's public in line with the country's policy on privatization. The IPO had successfully injected a large sum of capital into Transition Airlines. The company reported profits for the next three years after privatization. Stringent cost control and revenue generation were implemented. The flights were fully utilized and cost savings measures were directed on the operations. Retrenchment was undertaken to eliminate excess manpower.

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In the early 2000s, Transition Airlines had faced its first fall due to the financial crisis. The company's revenue was affected because of the decreasing demand of flights. Everyone in the country was badly affected by the crisis. Individual and family travellers chose to reduce their expenses by postponing or cancelling their travelling. Business travellers opted for cheaper flights by either switching to other airlines or choosing economy seats. Some flights had hardly broke even and some flights even operated at losses. The depreciation of the Grane Dollar (G$) worsened the company's condition.

The board of directors held a meeting with the management team to come up with a solution to the losses experienced. The chief operating manager proposed to cease several unprofitable routes: Based on the sales report, our sales for this quarter had significantly declined compared to last quarter. Sales had declined more than 50%; 20% of the current flights are still doing well and making profit but 65% are struggling to break even and 15% of them operate at a loss. If we continue operating the unprofitable routes, we will be reporting losses and cannot sustain ourselves through this crisis. I propose to cease the 15% unprofitable routes. We must stop the bleed right now.

Transition Airlines managed to recover its losses in 2006 but, unfortunately, it faced another crisis in 2008. The crisis was caused by poor revenue management and escalating fuel costs. The shareholders were frustrated as the company's share price dropped. The board of directors reviewed the company's performance and decided to fire the chief executive officer(CEO). A new CEO was appointed in 2006 to execute changes in corporate culture and operations. The new CEO studied the company's financial status and found that the company's books contained some strange transactions. He suspected there was a misappropriation of assets.

The new CEO decided to talk to the internal auditor of Transition Airlines. When the CEO stepped into the internal audit department's office, he was so surprised that the staff were not doing their work. They were either browsing social media, talking to one another or even dozing. He was very angry, but he did not alert the staff and walked straight into the room of the head of department. The head of internal audit was shocked by the presence of the CEO and quickly greeted him and then apologized to him. The CEO then asked the internal audit head what was happening in the office.

*'I'm so sorry, sir. We are trying to perform our tasks here but the whole organization does not seem to welcome us. We have tried to audit the other departments in the organization, but no one has given us cooperation. They just shunned us. We have brought this problem to the audit committee, but it did not take any action to improve this situation. We can't do anything without being given access to the system and information. We're just like a white elephant in this organization, here for the sake of corporate governance compliance. We are only provided with a two-page internal control report for the financial report. I'm really sorry for not performing well.'*

The CEO instructed the internal audit department to investigate and review the operations of the whole organization. The internal auditors were given authority to assess the whole company's operations and documents without fail. Those who declined to cooperate with the internal audit department would be given warnings and they could be removed from the organization. After a few weeks, the internal audit head met the CEO and reported their findings. He also pointed out the areas he suspected of fraud.

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There was revenue mismanagement in the company. The remuneration for the top management was unrealistically high. The expenses allocated for the top management, for instance marketing expenses and travelling expenses, were ridiculously high too. The management bought expensive artworks valued more than G$1 billion each to hang in their offices which served no purpose other than as decorations. According to the report, a new top management was formed and after a few months the financial condition of Transition Airplanes becomes better.

In 2016, Transition Airlines encountered another crisis with the loss of of its planes. On 3rd March 2016, the signal of flight GR808 was lost after leaving Grane to Crane carrying 250 passengers. After a few days, Transition Airlines received a call by strangers. This plane was hijacked by criminals. They asked the airline to pay the reparation for 3 billion. The stock price of Transition Airlines fell more than 42% after the incident. The company's share value had fallen heavily in the weeks prior to the vanishing of GR808. Since the vanishing of GR808, all the investors were frantically worried about the share price. However, all passengers were save but Transition Airlines had faced a big loss. Consolidated with the carrier's perpetual misfortunes, the GR808 calamity had walloped the company's wealth that year and rumours and guesses circulated whether Transition Airlines might be sold off or restructured. The company spent a huge sum of money to save all the passengers

Five months after this incident, flight GR68 crashed in Grane killing all 312 people on board. The airplane's flight data recorder and cockpit voice recorder were found at the scene of the crash. This tragedy was caused by bad weather during the flight and also pilot's error. This had further damaged the company's image as Transition Airlines had not recovered from its financial losses and had to suffer more losses due to the impact of the plane tragedy. The disasters had caused many passengers to be fearful to travel with Transition Airlines and some of them even cancelled their bookings. The airline not only faced share price and profit problems, it was also held responsible to help the victims' families. The company compensated the victims' families with a huge sum of money. Even before the incident happened, Transition Airlines had faced some obstacles as its competitors offered cheaper flight services.

The two incidents that had grabbed the world's attention had devastated Transition Airlines' reputation. It had also faced financial losses for quite a long period of time. The airline's financial performance was among the worst in the industry. The Grane's Government think to take over the airlines. This strategy to save more than 20,000 employees. It means that the company will be delisting from the stock exchange. However, the airplanes need to lay off at least 4,000 employees, shrinking its workforce to 16,000. The airlines need to restructure and redesign. All shareholders start selling their shares and employee turnover was high due to the financial condition of this airline.

The strategy that taken Grane's government were successful. Net sales increase to 30% although the fares of the tickets were cut-off to 20%. Many travellers start booking this airline again. The service had been upgraded but net profit increase to 15%.

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In 2019, world had been surprised by a virus named DOVID-19. DOVID-19 had killed many people and in 2020 most of the countries had implemented a serious action. Leaders of the countries had been worried and agreed to implement Movement Control Order (MCO). This action had given a big impact to airline industry especially Transition Airlines that had just recovered from the loss. In order to survive Transition Airlines had diversified the business to Transition Catering. Transition Catering provides delivering breakfast and lunch to the customers. However, the airlines still had to lay off many of its employee. The financial data shows that the company can only cover half of the overhead costs. Current ratio of the company shows 0:3 times and debt ratio increase to 0.8. but the expenses had been increased to 35% and still cannot cover the overhead cost.

Promotion and advertising had been carried out and managed to increase the sales to 30% but the expenses had been increased to 35% and still cannot cover the overhead cost. Extraordinary General Meeting had been conducted and this issue had been raise up. Many strategies had been suggested but nobody can decide the good decision. The meeting had been conducted the whole day to discuss the risk and key consideration for every issues but the conclusion had not been decided yet.

**REQUIRED:**

**Question 1**

(a). What are the differences between privatized entities and nationalized entities? Contrast the implications of privatization and nationalization of the airline towards the customers. Discuss.

(20 marks)

(b). Privatization may give benefit to customers. Do you agree with this statement? Justify your answers.

(10 marks)

**Continued...**

**Question 2**

(a). Transition airlines has appointed Mr ZZZ as the internal auditor. Mr ZZ has also been appointed as the operations executive. Is the appointment as the internal auditor of Mr ZZZ appropriate? Discuss the implications of this appointment based on the roles and responsibilities of an internal auditor.

(10 marks)

(b). Determine the difference between an internal auditor and external auditor.

(10 marks)

(c). Transition Airlines' internal auditor had not done their works properly. Do you agree with this statement? Justify your answer by using the examples in the case.

(10 marks)

**Question 3**

(a). In early 2000's, Transition Airlines had faced financial issues due to world financial crisis. Discuss the strategy that should have been taken by the Top Management

(10 marks)

(b). Transition Airlines had an issue regarding the company's ability to continue or to stop the operation in 2020. Briefly discuss this issue and please support your discussion with the relevant financial information.

(10 marks)

**Question 4**

What are the strategies that should be taken to improve the Transition Airlines situation in 2020? Give FOUR (4) business strategies and for each of the strategy, state the key consideration that need to be highlighted and the risk that will be faced by Transition Airlines.

(20 marks)

**End of Paper**